Nichols, Waldemar J.

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THE CO-INSURANCE CLAUSE

AN ADDRESS

Delivered before the One Hundred and
Twenty-Ninth Meeting

OF

The Insurance Society of New York

ON

March 7th, 1916

BY

Mr. Waldemar J. Nichols
GENERAL ADJUSTER
The North British and
Mercantile Insurance Co.

The Co-Insurance Clause

THE phrase "co-insurance clause" has two meanings, one general and one specific. The former applies in a general way to several different clauses intended to restrict the liability of an insurance company under a fire insurance policy to that proportion of the loss which its amount at risk bears to a given percentage of the value of the property at the time of the fire. Clauses designed to secure such result are of various wordings, some well and some poorly adapted to the common purpose. Each kind bears a name supposed to be descriptive; but, in a general way, all are referred to as co-insurance clauses. It is according to this general significance that the phrase is used in the title, and according to this significance we may use it until, later on, we undertake to distinguish the different kinds of clause. Thenceforward we shall use it only in its restricted sense.

In view of the admitted importance of the co-insurance clause, it would seem strange that so many of us fall short of its full comprehension, were it not for the peculiar ways in which it lends itself to the limitless combinations appearing in the apportionments of which it is a factor.

But one need not be discouraged by the seeming infinitude of its ramifications. Without actually exhausting the subject, one may have a good working knowledge of it; and we may profitably study its elementary features.

There is, as many of us know, great opposition to the co-insurance clause in many parts of the country; some States seeking, apparently, to discourage its use by loading it down with inconveniences; some prohibiting it except in all but a limited class of cases; while some prohibit it altogether.

In view of this disfavor, why is its use not abandoned? The best reason assignable is that it is the only factor that will secure justice to all in the matter of rates. And many of us believe that in the fullness of time, every State, even those now pro-

hibiting it, will permit and perhaps ordain its use. The realization of this belief will depend on the inherent justice of the principle involved. And it seems proper to consider its justice before we proceed to study its practical application.

Comprehension of the justice of the principle is more easily acquired than communicated to another; much more easily communicated to one with, than to one without practical experience in underwriting or the adjustment and apportionment of losses.

Many explanations have been formulated for the conversion of the average property-owner to the recognition of the necessity of the co-insurance clause for the maintenance of justice as between all policy-holders; but while they are sound and logical, the fact remains, as evidenced by the laws above referred to, hampering or preventing the use of the co-insurance clause, that all unwilling listeners have not yet been convinced.

The time available for the preparation of this paper has not permitted me, in addition to my regular duties, to undertake an exhaustive course of reading on the subject of co-insurance. I have, however, noted carefully and with profit the remarks relative thereto contained in the paper read by Mr. E. G. Richards at the annual meeting in October, 1908, of the Fire Underwriters' Association of the Northwest; also that portion of the report transmitted to the legislature of the State of New York on February 1, 1911, by the Joint Committee of the Senate and Assembly of that State; generally known, I believe, as the "Merritt Committee." Each paper presents an argument that should convince any intelligent and fairminded legislature of the justice of the universal application of the principle of co-insurance. We may profitably consider both papers, and, not inappropriately, in the order in which they were promulgated. It is interesting to note the different lines of thought along which the arguments run, as well as the harmony of their conclusions.

Mr. Richards views the principle involved as analogous to that of taxation. He refers to the necessity of uniformly just valuations of property as the basis of taxation.

All will admit that it would be both unjust and absurd to rely for purposes of taxation of real estate on valuations made by the owners, each for his own. All estimates would not be honestly made, and the dishonest would escape in great part the burdens of taxation, much of the burden properly accruing to

them being transferred to those whose estimates approached more nearly to the proper standard.

Manifestly, therefore, just as the valuations for real estate taxation must be uniformly proportionate to actual values in order that each shall make his proper contribution to defray the cost of benefits expected, so should valuations for purposes of insurance be uniformly proportionate to actual or sound values so that each policyholder shall make his proper contribution to defray the cost of benefits expected.

Manifestly, also, he does not live up to this obligation unless he does one of two things:

(a) Purchase insurance to a proper percentage of the value of his property; or

(b) Accept a policy for a less sum which must provide that in event of loss he shall receive no greater sum as indemnity therefor than will be proportionate to the amount of insurance he holds on the property.

The provision first designed to accomplish this result under Fire Insurance policies was denominated the Co-insurance Clause, and made the insured a co-insurer to the extent of the deficit in the amount of his insurance as compared with the amount of insurance needed to conform to the proper standard. This will be considered in detail later.

Rates are, we understand, based on the supposition that property owners will protect themselves by insurance to 80% of the values of their respective properties. Therefore, 80 is designated as the percentage of value in the Co-insurance Clause to be attached to a policy issued at the rate, made, as above indicated, in contemplation of insurance to that extent.

Mr. Richards, it will be seen, deals with fundamental principles.

Of the Merritt Committee report, that portion relating to co-insurance deals with illustrations, based in part on statistics, showing among other things that the principle

> "on which the co-insurance clause is founded is not only sound but is absolutely requisite if the equities of the insured are to be preserved."

The Merritt Committee report contains a statement of the average 100 losses shown by statistics to occur to every $100

worth of buildings of a certain class, the losses being divided into ten groups: the first group comprising those less than 10 per cent. of the values of the properties involved; the second, those exceeding 10 per cent. and less than 20 per cent.; and so on, 10 per cent. at a step, the last group consisting of losses exceeding 90 per cent. It goes on to show that

> "Every 100 fires burn altogether $916 worth of property, supposing the properties in each case to have had a value of $100."

These statistics not convenient of quotation here, show that if on each building just $10 of insurance had been carried for every $100 of value, the 100 losses would have cost the Companies $344 (34.4% of the insurance):

That if the insurance had been $20 for each $100 of value, the cost to the Companies would have been $488, being 24.4% of the insurance;

If	$30,	$593,	being	19.77%	of	the	insurance;
"	40,	673,	"	16.82%	"	"	"
"	50,	738,	"	14.76%	"	"	"
"	60,	793,	"	13.22%	"	"	"
"	70,	838,	"	11.97%	"	"	"
"	80,	873,	"	10.91%	"	"	"
"	90,	898,	"	9.98%	"	"	"
"	100,	916,	"	9.16%	"	"	"

We quote from the report:

> "The principle that is here established is that the rate in fire insurance must equitably depend not only upon the class of risk, but upon the percentage of insurance carried, and that for example a rate of ninety-three cents which might be right if 80 per cent. of insurance were carried would be much too low if only 30 per cent. were carried."

It clearly appears from the able arguments presented by these authorities that if rates are based on the assumption that insurance to a certain percentage of the value will be carried, the rate is right only where, in event of loss, the Company is called on to pay only that proportion of the loss which its policy bears to the percentage of the value contemplated in the rate,

whether this limit on its paying power results from the amount of insurance carried or from the presence in the policy of the appropriate co-insurance clause.

If a policy written at a given rate must pay, up to its amount at risk, for any loss regardless of whether the percentage of insurance to value be large or small, one of two things is true; either the insured is overcharged if the percentage of insurance to value be high, or undercharged if it be low.

Because one who insures to a small percentage only of his value may suffer a large uncollectible loss if the percentage of loss be high, the extent of such inequity as between policyholders is somewhat restricted. But the best that can be said of this restraining influence is that its results are less unjust than would be those of a law granting to the property owner the right to demand at the rates current under present conditions, and *after the fire*, insurance to meet his needs as then developed.

Losses are not met by the premiums charged for the policies under which the losses occur. In life insurance every risk is expected to be a total loss sooner or later, and the rate charged is regulated accordingly. If in fire insurance the policies under which no claim is ever made were less than a great majority of the policies written, the rates charged would need to be increased manyfold. It is approximately true that losses are paid by the premiums on the policies under which no loss occurs—in fact the premiums on policies under which losses occur would not be anywhere near sufficient to pay the expense of conducting the business, to say nothing of losses—and unless there is some influence at work to keep the revenue from these policies at current rates up to a proper level, the receipts therefrom will fall so as to require the rates to be materially increased. This influence is only partially supplied by the fear of loss equal to or approaching the value of the property. It must in fairness to all—Companies and policyholders alike—be supplemented by some provision in the policy contract restricting the Company's liability for loss to that proportion thereof which its policy bears to the percentage of the value which was contemplated in the rate.

Now, I submit that the foregoing arguments should suffice to convince any well informed and fair minded body that, regardless of justice to the Insurance Companies, equity as between

policyholders demands the application, to all policies, of the principle of co-insurance. But the fact remains that the Solons of several States have not yet seen the light. Bearing in mind that "fools rush in where angels fear to tread" a mere adjuster might well hesitate to attempt to supplement the able arguments already presented with any of his own. And yet, remembering that a straw, applied at the critical moment, has broken a camel's back, I venture to present, for consideration as a possible straw, an argument differing from, but consistent with those already noticed.

The great majority of fire losses are on property susceptible to any degree of loss, however large or however small. Some classes of property there are whose destructibility in event of fire is extreme. As an example, we may cite kerosene or gasoline in the simple form of tank with no provision for the removal to a place of safety of part of the contents. Almost if not quite as striking an illustration is hay in stack. Many classes of unprotected property are doomed to a total loss if fire occur.

On the other hand, there are classes of property which, owing to one cause or another, or to combinations of causes, are prolific in small losses and only in exceptional cases are subject to heavy or total loss.

But in the great majority of cases the property (building or contents, or both) is of such a nature that neither an insured nor his insurer can reasonably pin his faith to any special percentage of loss in event of fire. And it is this great majority of cases to which our argument is directed.

As a foundation, let me state what I believe must be conceded to be a fundamental truth: That if two policies, each for the same amount, are issued on the same property, the first to cover till exhausted and without contribution from any other insurance, on any loss that the property may sustain, the other to apply only to so much of the loss as exceeds the amount of the first policy, the first policy is equitably entitled to a higher rate than the second. This granted, let us assume that, as must often be the case, the difference in rate between two such policies, each for $1,000 on property worth $2,500, is one-third of the greater. That is to say, if, in such a case, 60 cents per $100 is the proper rate for the first, 40 cents per $100 will be the proper rate for the second, the premiums being $6 and $4 respectively.

Next, let us consider instead of these two policies a policy for their aggregate amount, $2,000, so written as to cover till exhausted and without contribution from any other insurance on any loss that the property may sustain. This policy will yield in any conceivable case exactly the indemnity that would be yielded by the two $1,000 policies previously considered; exactly that and no more. Therefore, it is worth exactly as much as should be charged for the two $1,000 policies. The premium on the $2,000 policy should therefore be $10 and the rate, in consequence, 50 cents per $100.

Let us apply first the two $1,000 policies, and then the $2,000 policy to a loss of $1,500.

The first $1,000 policy will pay $1,000; the second will pay $500.

On the other hand, the $2,000 policy will pay $1,500.

Suppose it were desirable to issue two policies for $1,000 on the property in question each at the rate, 50 cents per $100, that had been found to be equitable or the $2,000 policy. In order for the rate to be as fair for each of the $1,000 policies as it was for the $2,000 policy, it is manifest that provision must be made whereby, just as the $2,000 policy pays the whole of any loss not exceeding $2,000, so each $1,000 policy will pay one-half of any loss not exceeding $2,000.

It may be asked why it is necessary to make such provision, as each of the policies will pay its proportion (one-half) according to the contribution clause. The answer is that either policy may be canceled at any time, leaving the other the only insurance on the property. Without the special provision indicated as necessary, it would then have to pay the whole of any loss up to $1,000 instead of one-half of any loss up to $2,000. This would be inequitable as, for a 50 cent rate, it would be carrying all the burden of the underlying $1,000 policy, for which the fair rate we know to be 60 cents.

Therefore, if the $1,000 policy is to be sold at a 50 cent rate, it must be relieved of all burdens except those contemplated by that rate. This can only be done by a provision, however worded, whereby liability under the policy, which, of course, can never exceed its amount at risk, is limited to that proportion of the loss which its amount at risk bears to 80% of $2,500, the value of the property.

In presenting the above argument, we have considered policies for 40% and 80% respectively of the sound value of the subject of insurance; it has been assumed that the proper rate for the underlying policy was 60 cents, and that for a 40% excess policy 40 cents; and we have seen how it followed that, in these circumstances, the proper rate for an ordinary policy subject to the 80% clause was 50 cents. But these particular factors were taken merely for convenience. The argument will hold good though other percentages of value be substituted for 40% and 80% and though other rates be assumed than 60 cents per $100 and 40 cents per $100. The conclusion will always be that, as to property susceptible of any degree of loss, large or small, the lower the percentage in the co-insurance clause, the higher must be the rate.

To sum up the arguments in favor of the co-insurance clause:

In any State that forbids its use, the rate for insurance being based entirely on the comparative hazard of the risk, one of two things *must* happen while both *may* happen: either the property owner who takes out insurance for 80% or more of the value of his property will pay too high a rate, or the one who insures against loss on the same class of property for a smaller percentage of its value will obtain it at too low a rate. Let not the State delude itself into the belief that it is not concerned if one of its citizens obtains something for nothing or for a sum less than cost. Nothing can be truer than that "the consumer, he pays the tax," later if not sooner.

The States that are so opposed to the co-insurance clause are noticeably apt to favor anti-discrimination laws in the matter of rates.

But as one kind of discrimination in the cost of insurance is as unfair as another, let us consider whether discrimination is inhibited by statutes which provide that rates must be proportioned to the comparative liabilities of various properties to loss by fire, while, at the same time, they forbid the use of co-insurance or average clauses.

If 1% is the proper flat rate for A's property, and the hazard of B's property to that of A's is as 5 is to 4, B's property must be rated at 1¼% flat. Now, according to the anti-discrimination statute, it would be reprehensible for an insurance company to issue a policy of B's property at a rate less than 1¼%, yet if B because of the greater hazard of his property, deems it prudent to maintain insurance up to 80% of his value while A insures up to 40% only of his value, B's insurance involves a less risk to the insurers and, to avoid discrimination, should bear a rate lower than A's rate; yet under the so-called "anti-discrimination law," B must not be permitted to obtain his insurance at a rate less than 1¼%, no matter how much he may decrease the risk to the insurer by increasing its amount.

To one who is influenced by the arguments we have considered, this seems as great a discrimination against B as it would be if policies to 80% of the value on property of like hazard to that of his were issued at the rate of 1%, while the charge to him therefor remained at the 1¼% rate.

It is to be hoped that a realization by those opposed to discrimination, that the prohibition of co-insurance produces rather than prevents it, will lead to the abolition of discrimination, so far as possible, in the only known (or conceivable) way, viz.: Proper adjustment of rates, based in each case upon some assured percentage of insurance to value, and the requirement of a co-insurance clause based upon the same percentage of insurance to value.

Let us pass now to the consideration of the operation of the clause:

As has already been called to your attention, the phrase "co-insurance clause," in the foregoing portions of this paper, has been held to include not only the co-insurance clause proper, but also other clauses differing in form but likewise denominated co-insurance clauses, and still other forms of clause known as the "reduced rate average clause," or, as in New York City, the "average clause."

A careful analysis of the various forms of clause in use throughout the United States shows that they may be properly analyzed as follows:

First: The co-insurance clause proper providing, with little, if any, variation, that the insured shall maintain insurance upon the property hereby insured to the extent of at least ......% of the actual cash value at the time of the fire, and failing so to do, shall, to the extent of such deficit, bear his, her, or their proportion of any loss.

Second: The percentage co-insurance clause, reading substantially as follows:

> "If at the time of fire the whole amount of insurance on the property covered by this policy shall be less than ......per cent. of the actual cash value thereof, this Company shall in case of loss or damage be liable for only such portion of such loss or damage as the amount insured by this policy shall bear to the said ......per cent. of the actual cash value of such property."

This, as will later appear, was a long step in the right direction. It is a reasonable guess that the author or authors thereof supposed that it did away with the inequities (iniquities) of the Co-insurance Clause, by giving the insurer the benefit of what we now know as the Average Clause, whenever, by reason of insufficient insurance, the benefit was needed.

Third: The average clause, reading substantially as follows:

> "This Company shall not be liable for a greater proportion of any loss or damage to the property herein described than the sum hereby insured bears to ......per cent. of the actual cash value of said property at the time such loss shall happen."

Fourth: The reduced rate clause, reading substantially as follows:

> "In consideration of the reduced rate at which this policy is written, it is expressly stipulated and made a condition of the contract that, in event of loss, this Company shall be liable for no greater proportion thereof than the amount hereby insured bears to ......per cent. of the actual cash value of the property described herein at the time this loss shall happen, nor for more than the proportion which this policy bears to the total insurance thereon."

It will be seen that this clause is substantially the same as the average clause, except for the fact that a consideration for its incorporation in the policy is expressed, the consideration being the reduced rate at which the policy is written.

In the foregoing quotations I have included only the principal paragraph of each clause. Combined with each is usually found a provision restricting, to some extent, the application of

the clause to losses less than five per cent. of the insurance, or value; and frequently also another making the clause apply specifically to each item of a multiple item policy.

I shall not indulge in a recital of the origin and the history, prior to the last thirty years, of the co-insurance clause. Firstly, we haven't the time; secondly, the recital might be too technical; and thirdly, I know nothing about it. All I know is that about thirty years ago it was introduced to the fire insurance fraternity of my boyhood home, the greatest city in the world, Chicago, where I was learning the rudiments of the business, including the distinction between underwriter and rate-cutter, and from that time to the present it has kept me so busy trying to find out what it is and how to deal with it that I have had no time for inquiry as to its previous history or its genealogy.

The original form of co-insurance clause, at least so far as the writer knows, was that first above set forth.

This, so far as I recall, worked very well for a time. Sooner or later it was discovered that the owner of a plant comprising subjects of insurance of different degrees of fire hazard and, consequently, differently rated, could circumvent the clause. As an illustration, suppose a manufacturing plant, of the value, in the aggregate, of \$100,000, a part, valued at \$50,000, being rated at 1%, the remainder being rated at 2%. Instead of taking \$80,000 insurance in concurrent policies, each covering the entire plant subject to the 80% clause at the average rate of the entire plant, 1½%, premium \$1,200, he would obtain \$50,000 of insurance blanket over the whole plant at the average rate of 1½%, premium \$750; and \$30,000 of insurance covering specifically, subject to the 80% clause, on the low-rated portion of the risk at 1%, premium \$300; total premium, \$1,050 instead of \$1,200, thus saving \$150, 12½% of the premium he would have had to pay had he taken it all at the 1½% rate covering blanket over the whole plant, as the companies issuing the blanket policies supposed him to be doing.

In event of loss on the low-rated item, the assured would properly collect his entire loss as it would be covered by both sets of policies.

If, however, the loss occurred, wholly or in part, on the high-rated risk covered by the blanket policies only, the claim would be made that the blanket policies must pay the entire loss

on the high-rated risk. The Company could not claim contribution as to the loss on the high-rated risk from the other insurance, as such loss was not covered by the other insurance, and was denied any benefit from the co-insurance clause, because of the contention that the insured had insurance (not on the whole property it is true, but at least on a portion of it) to the stipulated percentage of the combined value of both items of property.

It was probably to avoid some of the troubles caused by such non-concurrences as we have considered, that the second clause above set forth was formulated.

This clause does, in many cases, secure the results intended for it; and, as will hereafter appear, I am disposed to believe that the courts should construe it in all cases as meaning the same as the average clause with which we New Yorkers are so familiar, and which we shall consider later. But it has been so construed by loss claimants and their representatives as to nullify the intention of the drafters in cases where, with non-concurrent insurance, and loss on that portion of the property covered only by the broadest policies, some of the insurance covering on all of the property and all of the insurance covering on some of the property, the aggregate being not less than the percentage of value stipulated in the clause, the insured has insisted that the conditions of the clause have been complied with, so that the restriction on the Company's liability could not be invoked.

Some adjusters have conceded in the past, and some still concede the force of this argument. As I view the clause, these adjusters have been misguided or too timid. I do know that one illustrious member of this society, when apportioning an adjusted loss under policies so written, carried his point and enforced a very heavy contribution by the assured by arguing in behalf of the blanket policies, which alone covered the property damaged, substantially as follows:

> "If you have insurance to 80% of the value of the property covered by the blanket policies each of these policies will, by virtue of its contribution clause, pay that proportion only of the loss which the amount insured under said policy bears to the total insurance. If your insurance is, in all, less than 80% of the value of the property, each blanket policy will, by virtue of the 80% clause, pay that proportion of the loss which the amount insured by said policy bears to 80% of the value of the property covered by the policy."

To my mind, the absurdity of any other construction than that successfully defended by our mutual friend can be clearly exhibited by comparing the results of two hypothetical but easily possible cases. In each there are two items of property, A and B. In the first case the factors are as follows:

	A	B
Sound value	$100,000	$100,000
Insurance	60,000	
Subject to 80% cl.	$100,000	
Loss		$100,000

According to the assured's construction which, for the sake of the illustration, we follow, the blanket policies would pay the entire loss, $100,000, because the aggregate of the non-concurrent policies is $160,000, being 80% of the value of the property covered by the blanket policies which alone, let me repeat, cover the damaged property.

Now, for our second case, let us assume that the factors are the same as in the first except that the sound value of A is increased $1.00. The problem then appears thus:

	A	B
Sound value	$100,001	$100,000
Insurance	60,000	
Subject to 80% cl.	$100,000	
Loss		$100,000

The only insurance covering B is the blanket insurance of $100,000.

The total sound value is $200,001; the total insurance is $160,000—less than 80%. Therefore, according to the 80% clause the blanket policies are liable for no greater proportion of the loss than that which their amount, $100,000, bears to 80% ($160,000.80) of the sound value of the property; the result being that the blanket policies pay $62,499.69. The increase of $1.00 in the sound value, every other factor remaining the same, reduces the collectible loss $37,500.31.

Anyone who wishes to believe that a change of $1.00 in

sound value can effect a change of over $37,500 in collectible loss is, under the constitution of the United States, guaranteed the right so to do. But he must not expect us all to agree with him.

So far as I know, only one court of last resort has decided a case arising under this clause where the insured had blanket insurance on two items of property with specific insurance on one only, the amounts at risk under the two sets of policies aggregating as much as, or more than the stipulated percentage of the value of both items, the loss being confined to the item covered by the blanket insurance only. The court in its decision held that the clause did not reduce the loss collectible under the blanket policies because the total insurance equaled the percentage of value named in the clause. It should be said in explanation that the contest in this case involved the question whether all policies covered blanket on two items of property or whether part were confined in their cover to the undamaged item only.

It appears to have been conceded by the adjusters and other company representatives that, however the question might be decided by the courts, the insured would recover full indemnity. In consequence, when the attorneys for the blanket policy companies came to prepare their pleadings, they found themselves precluded from the following contention: that either there was or was not insurance on the property (both items) to the percentage of value named in the clause; that if there was, the blanket policy companies should pay only such proportion of the loss as their amounts bore to the total insurance; whereas, if there was not, they should pay only that proportion of the loss which their amounts bore to the stipulated percentage of the value. The point not being contested, the court, holding that part only of the policies covered on the item involved in the loss, naturally held also that they must pay the entire loss.

Probably it was long ago recognized that while the clause we have been discussing might, if tested, stand the strain, it was, nevertheless, variously construed even by company representatives. And it is reasonable to suppose that the clause so long in use in New York City and other parts of the country and known here as the "Average Clause" was formulated for the elimination of all doubt and discussion. It read as follows:

"This Company shall not be liable for a greater proportion of any loss or damage to the property described herein than the sum hereby insured bears to..........per centum (........%) of the actual cash value of said property at the time such loss shall happen. In case of claim for loss on the property described herein not exceeding five per cent. (5%) of the maximum amount named in the policies written thereon and in force at the time such loss shall happen, no special inventory or appraisement of the undamaged property shall be required. If the insurance under this policy be divided into two or more items, these clauses shall apply to each item separately."

To those familiar with it, this clause is free from ambiguity or doubt in so far as may be involved its restricting the liability of a company, in any conceivable case, to that proportion of the loss which its policy bears to the stipulated percentage of the value of the property at the time when such loss shall occur. Any doubt they may have as to its effect arises when it is to be construed, in cases of non-concurrence, in connection with the contribution clause. The apportionment of loss under non-concurrent policies is an interesting theme, but it has been assigned to another, so I leave it untouched.

Even so, the average clause affords room for discussion. It is customarily met either as the 80% or 100% average clause. It is surprising how many people, even some actively engaged in the insurance business, consider these clauses as if the effect of the 80% clause was to restrict the insured's collection, in event of loss, to 80% of the loss sustained, while the policy with the 100% clause permits the collection of the entire loss. This is, of course, amusing to one familiar with the subject. But what are we to do about it?

It is very easy to tell our misguided friend that his conception of the Average Clause is radically—fundamentally—wrong. But how are we to make clear to him its real meaning and the results of its proper application? Or rather, perhaps, how are we to arrive for ourselves at a clear understanding of the real meaning of the clause and the results of its proper application, so that the knowledge may be imparted to him?

Very simply if we have digested that part of the arithmetic devoted to common or vulgar fractions. The restrictive effect of the clause is measured by a fraction of which the numerator

is, in every case, the product of the amount in dollars of the loss and the number of dollars in the amount at risk under the policy; the denominator varying according to circumstances.

(a) If neither loss nor insurance exceeds the stipulated percentage of value, the number of dollars in the percentage of value is the denominator.

Thus, if, in a given case the factors are:

Loss	$5,000
Insurance	2,000
Average Clause	80%
Sound Value	10,000

the fraction will be

$$\frac{\$5000 \times 2000}{8000} = \$1,250 = 25\% \text{ of the loss.}$$

Had the clause designated 100 instead of 80 as the percentage, the fraction would have been

$$\frac{\$5000 \times 2000}{10000} = \$1,000 = 20\% \text{ of the loss.}$$

(b) If the loss but not the insurance equals or exceeds the stipulated percentage, the denominator is the number of dollars in the loss, the equivalent of the fraction being the amount at risk.

Thus, if, in a given case the factors are:

Loss	$9,000
Insurance	2,000
Average Clause	80%
Sound Value	10,000

the fraction will be

$$\frac{\$9000 \times 2000}{9000} = \$2,000 = 100\% \text{ of the ins.}$$

Had the clause designated 100 instead of 80 as the percentage, the case would have fallen into class A, as in that event neither loss nor insurance would have exceeded the stipulated percentage.

Or if the factors are:

Loss	$11,000
Insurance	2,000
Average Clause	80%
Sound Value	10,000

the fraction will be

$$\frac{\$11000 \times 2000}{11000} = \$2,000 = 100\% \text{ of the ins.}$$

Had the clause designated 100 instead of 80 as the percentage, the case would also be in class B, as the loss would still have exceeded the stipulated percentage.

(c) If the insurance equals or exceeds the stipulated percentage, the denominator is the number of dollars in the amount at risk, the equivalent of the fraction being the amount of loss.

My recommendation to the student is that he construct for himself a series of different combinations of loss, insurance and sound value, applying to each the 100% and the 80% average clauses, each combination thus yielding two problems. Let him assume that any man is fallible and that my generalities, so confidently stated, may not be universally true and that it is his duty to find the lurking error. Let him preserve his notes so that when he has enough solutions he may compare them and see for himself how the average clause adapts itself to varying conditions and with what results. The adjuster or the proof-checker finds his examples ready-made for him among the apportionments that he must make or verify.

Probably a small percentage only of brokers, active in the prosecution of the Fire Insurance business, need the exposition of the Average Clause above given. But experience and observation lead me to believe that many could profit by a warning with regard to one phase of the subject.

The average clause, as has been sufficiently argued, is essential to the proper conduct of the business. Non-concurrent insurance, while troublesome to him who has to apportion losses

thereunder, cannot by itself be considered in any way reprehensible. But the combination of the two is dangerous and should be consistently avoided by every broker and policy holder.

If all policies on a risk cover on exactly the same property, it is proper to say that if the insurance equals or exceeds the percentage of value stipulated in the average clause, the assured, in event of a loss not exceeding the insurance, will, so far as relates only to the average clause and the contribution clause in the body of the policy, be fully indemnified. It is not every broker who knows this; and of the many who do there are some who misapply the knowledge.

Any adjuster in active practice here in New York City may occasionally find that an assured has non-concurrent policies, each subject to the average clause, the aggregate of the amounts at risk equaling or even exceeding the stipulated percentage of value, but with the values and non-concurrences so distributed that the aggregates of the average clause limitations of the several policies, although the maximum of possible collectibility, is insufficient to indemnify the assured.

A notable, but not solitary, instance of this kind came to light some years ago in connection with a Committee loss, interesting especially, both then and now, because of the manner in which the non-concurrence arose. At first glance the policies seemed to cover alike on merchandise in two buildings. After the fire, however, it was discovered that a majority only of the policies were subject, as required by the rules of the Exchange, to the average distribution clause as between the two buildings. The apportionment of the loss agreed to by insurers and insured as correct, particularly as to the application of the average clause feature of the several policies, developed an uncollectible loss of some thousands of dollars.

Dry the starting tear. The deficit was supplied by ex gratia payments by some of the companies. These seemed justified by the high character of the assured, their fairness in the adjustment of the loss, and the elusive way in which the error had escaped attention.

Far be it from me to deprecate the exercise of the act of grace in special circumstances. But neither the broker nor the insured should count on it when the contract is made. Indemnity for the loss is, I am sure, most pleasing to the broker's customer

when it is paid in discharge of an obligation legally incurred for value received.

While there are brokers who scrutinize their policies so carefully that when delivered they are free from material errors, there is room in which others, younger and less experienced let us hope, may improve themselves.

But there is one factor for mischief that all a broker's care and foresight cannot always counteract. I refer to the claimant who has two brokers and letteth not his right hand broker know what his left hand broker doeth. What this kind of assured cannot achieve in the way of snarling things up for the broker chosen to represent him, also for the adjusters for the Companies, is hardly worthy of extended notice in a paper of this kind. As for what the adjusters think of him—well—let it go at that.

Another practice has the sanction of such long standing and, seemingly, at least, the approval of so many excellent authorities that one may not hopefully venture its condemnation. Yet it has in some cases resulted unprofitably for the insured and may reasonably be expected to do so again. I refer to the practice of having insurance, subject to the average clause, cover on the property of the assured and, as well, that of others, generally by incorporating the commission clause in the policy.

The commission clause has caused embarrassment and loss to the assured where there was no average clause. The probability of embarrassment to him is even greater with it.

Mrs. Johnson sent her victoria to the shop of the Chas. Abresch Company to be painted. The Abresch Company, so far as disclosed by the record, assumed no liability for damage to the victoria except such as, in the absence of any express contract, accrued to it in event of loss or damage to the victoria as the result of its negligence or that of its employes. Fire in no way the result of any negligence of theirs, damaged or destroyed property of the Abresch Company and, as well (or ill), the victoria belonging to Mrs. Johnson. The Abresch Company collected the face of its insurance, supposedly for the loss to its own property. There is nothing in the record to suggest that it was overpaid thereon. Mrs. Johnson had not obtained insurance to protect her against loss on the victoria. She would have had no recourse against the Abresch Company had it had no insurance covering on her property. But she learned that the Abresch

Company's policy covered not only the Abresch Company's property but also that held by it on storage or for repair. She accordingly demanded of the Abresch Company a share of the money paid by its insurer. The Abresch Company refusing, she sued it. The case was appealed to the highest court of the State (Wisconsin), which decided that Mrs. Johnson should share in the money in the proportion that the value of her property bore to the combined value of her property and that of the Abresch Company.

My friend, James E. Underhill, now deceased, was known to many of you as proprietor of a picture and picture framing establishment at the corner of Nassau and John Streets. He had a valuable stock of his own. He also had in his possession on storage, framed pictures and other valuable property belonging to others. He also had pictures and other articles left with him to be framed. His policies covered his own property and that of his customers. Both were damaged by fire originating in a part of the building not occupied by him.

Sound value of his own property and the loss thereon were readily ascertained, but proofs could not be made or approved till the value of and loss on customers' goods were also ascertained. Some of his customers were wholly reasonable. All were not. The adjustment was a trouble to him in spite of all that could be done by him and the Companies' adjuster, although they were in perfect accord. As a result of this experience he wisely decided that thereafter his own property should be covered by itself under one set of policies, while the property of customers should be covered by another set from whose protection his own property was, by specific agreement in the policies, excluded.

The Abresch-Johnson case was not a New York case, but there is no certainty that the decision would have been any different here. The Utica Canning Company decision, so well known that quotation is not necessary at this time, inflicted no uncollectible loss on the assured, Louis DeGroff & Son, as there was enough insurance to cover the loss to both concerns. But suppose the insurance held by the DeGroffs, subject to the Average and Commission Clauses, had been insufficient or barely sufficient to indemnify them for their own loss; what would have been the result? Do the Abresch decision and the Utica Canning Company decision read together, indicate anything but danger to the interests of the party who takes out and pays for insurance subject to the Commission Clause supposedly for his own protection first?

This is a danger that the Insurance Companies are powerless to avert. Policies subject to both Average and Commission Clauses are desirable for some people in some circumstances. The Companies are in no position to decide whether such a policy does or does not fit the assured's needs. The decision can only be made properly by the assured, and by him only after his broker has explained to him the danger of taking insurance covering blanket both on his and on his customers' goods.

I will close my paper with two things for you to reflect upon: a question and a suggestion. The question is this:

Assuming property of a Sound Value of $10,000, an insurance policy thereon subject to the 100% Average Clause, and a loss. What is the amount of the policy and what is the amount of the loss that, because of the Average Clause, will yield the greatest uncollectible loss?

The suggestion is this:

As the average clause is current wherever in New York State any clause coming within the general meaning of "co-insurance clause" is used, and as it involves no mathematics save "ratio and proportion," let the Board of Regents of the State prescribe it as one of the problems to be understood by the teachers of arithmetic throughout the State and taught to all their pupils. This would be easily done, and when the children of the State begin to understand the Average Clause, they will in many cases impart their knowledge to their parents. And in time the public, through this educational process will realize not only the absolute necessity of applying the principle of co-insurance, if the insurance burden is to be equitably apportioned among the property owners of the country, but will wonder why so self-evident a proposition should at any time have been regarded as even debatable.

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